

WATER INFRASTRUCTURE FINANCE  
AUTHORITY OF ARIZONA

PHOENIX, ARIZONA

FINANCIAL STATEMENTS

Year Ended June 30, 2006

WATER INFRASTRUCTURE FINANCE AUTHORITY OF ARIZONA

FINANCIAL STATEMENTS

Year Ended June 30, 2006

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HENRY & HORNE, LLP  
Advisors to Business

### Independent Auditors' Report

Board of Directors  
Water Infrastructure Finance Authority of Arizona  
Phoenix, Arizona

We have audited the accompanying financial statements of the Water Infrastructure Finance Authority of Arizona, a discrete component unit of the State of Arizona, as of and for the year ended June 30, 2006, as listed in the table of contents. These financial statements are the responsibility of the Water Infrastructure Finance Authority of Arizona's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Water Infrastructure Finance Authority of Arizona, as of June 30, 2006, and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis is not a required part of the financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

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## MANAGEMENT'S DISCUSSIONS AND ANALYSIS

As management of the Water Infrastructure Finance Authority of Arizona (Authority), we offer readers of the Authority's financial statements this narrative overview and analysis of the financial activities of the Authority for the fiscal year ended June 30, 2006. We encourage readers to consider the information presented here in conjunction with the Authority's financial statements.

### HIGHLIGHTS – BUSINESS TYPE ACTIVITIES

- In 2006, total assets increased by \$217 million as compared to 2005. This was primarily due to a new bond issue completed during the year.

### USING THIS ANNUAL REPORT

The financial statements included in this annual report are those of a corporate and politic body of the State of Arizona. The following statements are included:

- Statement of net assets – reports the Authority's current financial resources, noncurrent financial resources, current obligations, long-term obligations, and the resulting net assets.
- Statement of revenues, expenses and changes in fund net assets – reports the Authority's program revenues, program expenses, nonprogram revenues, and capital contributions.
- Statement of cash flows – reports the Authority's cash flows from operating activities, investing, and non-capital activities.

### STATEMENT OF NET ASSETS

Years Ended June 30,	2006	2005
Cash & Equivalents	\$262,210,416	\$147,746,319
Investments	80,895,835	68,081,810
Loans	574,935,091	489,071,853
All Other Assets	14,321,904	9,867,163
Total Assets	932,363,246	714,767,145
Bonds Payable	582,560,000	405,675,000
Interest Payable	5,112,384	5,027,882
All Other Liabilities	31,894,050	21,661,342
Total Liabilities	619,566,434	432,364,224
Net Assets Invested in Capital Assets	7,818	11,728
Restricted Capitalization for Grants	261,156,467	240,079,736
Unrestricted	51,632,527	42,311,457
Total Net Assets	\$312,796,812	\$282,402,921

The Authority net assets increased to \$312,796,812 during 2006, an increase of \$30,393,891 over 2005. The increase in net assets was primarily the result of capital contributions and loan activities.

#### REVIEW OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

The following table shows the condensed statement of revenues, expenses and changes in net assets for the past two years.

Years Ended June 30,	<u>2006</u>	<u>2005</u>
Program Revenues:		
Program loan interest revenue	\$11,033,742	\$9,287,547
Debt management fees	<u>7,636,139</u>	<u>5,474,743</u>
Total program revenue	<u>18,669,881</u>	<u>14,762,290</u>
Program Expenses:		
Administrative expenses	2,615,661	2,632,957
Technical/financial assistance	541,232	519,062
Program loan interest expense	<u>17,397,886</u>	<u>17,884,713</u>
Total program expenses	<u>20,554,779</u>	<u>21,036,732</u>
Program loss	(1,884,898)	(6,274,442)
Non-program revenues	<u>11,202,058</u>	<u>9,551,368</u>
Income before contributions	9,317,160	3,276,926
Capital contributions	<u>21,076,731</u>	<u>7,476,784</u>
Change in net assets	30,393,891	10,753,710
Beginning net assets	<u>282,402,921</u>	<u>271,649,211</u>
Ending net assets	<u>\$312,796,812</u>	<u>\$282,402,921</u>

Compared to 2005, total expenses decreased by \$500,000. The decrease was primarily due to a reduction in interest expense.

WIFA relied on significant federal capital contributions and bond proceeds to fund loans in 2006 and drew contributions from multiple open federal capitalization grants.

### BUDGETARY HIGHLIGHTS

The Authority's Board of Directors adopted an operating budget of \$1,662,019 for the period July 1, 2005 through June 30, 2006.

<u>Budget Line Item</u>	<u>Amount</u>
Salaries & Benefits	\$1,118,619
Professional & Outside Services	195,800
In State Travel	21,200
Out of State Travel	20,000
Other Operating	218,600
Equipment	45,300
Indirect Cost	42,500
Total	<u><u>\$1,662,019</u></u>

### CAPITAL ASSETS

The Authority's capital assets consist primarily of computer equipment. In 2006, the Authority capitalized no new equipment.

### DEBT OUTSTANDING

Years Ended June 30,	<u>2006</u>	<u>2005</u>
Beginning balance	\$ 405,675,000	\$ 417,400,000
Refunded Bonds	-	-
Refunding Bonds	-	-
Additions	205,400,000	-
Payments	(28,515,000)	(11,725,000)
Ending balance	<u><u>\$ 582,560,000</u></u>	<u><u>\$ 405,675,000</u></u>

### ECONOMIC AND OTHER FACTORS

#### Drinking Water Standard for Arsenic

In October 2001, the United States Environmental Protection Agency adopted a new standard for the amount of arsenic permissible within drinking water. The new standard decreased the maximum amount of arsenic from 50 parts per billion to 10 parts per billion. According to estimates from the Arizona Department of Environmental Quality, the new arsenic standard will affect approximately 3,000,000 customers of drinking water systems throughout Arizona. Under the current requirements, drinking water systems have until

January 23, 2006 to achieve compliance with the new standard or will fall out of compliance and face penalties.

As a result of the need to comply with the new federal standard, the Authority anticipates continued high demand for its drinking water financial assistance from small water systems. Many of these small water systems will require significant rate increases to accommodate the capital and operating costs associated with arsenic treatment. Accordingly, the Authority anticipates providing increased financial assistance in 2007.

#### Authority Automation Efforts

The Authority continues to develop and implement fiscal related applications to automate its financial activity.

#### Inequity in the Clean Water State Revolving Fund (CWSRF) Capitalization Grant Funding Allocation

Congress appropriates funding to EPA which, in turn, grants allocations to states to capitalize CWSRFs in accordance with state-by-state federally enacted allocation percentages. As originally intended by Congress, CWSRF allocations to states should be based on population and documented needs.

The present allocation percentages are based on a 1977 formula using data from the 1970 census and the 1974 wastewater needs survey. Present allocations favor the Northeast and Midwest regions at the expense of the remainder of the country, particularly the Southeast and Southwest regions. While the population of the U.S. continues to migrate south and west, the vast majority of the funding for infrastructure remains in the Northeast and Midwest.

Based on Census Bureau data, Arizona's 2000 population approximates 5.1 million, ranking 20<sup>th</sup> for population by state. However, Arizona is 53<sup>rd</sup> out of 53 for CWSRF allocations per capita.

Based on EPA's 2002 Needs Survey, Arizona certified nearly \$6.3 billion in wastewater infrastructure needs, ranking 10<sup>th</sup> for needs by state. However, Arizona is 52 out of 52 for CWSRF Allocations compared to certified need.

A new clean water needs survey was completed in FY 05 with the results expected in FY 07.

Arizona currently receives only 0.68% of the CWSRF appropriation. Based on allocations to states with similar needs, Arizona should receive 3.54% of the CWSRF appropriation, more than five times more than it currently receives.

A conservative estimate indicates that Arizona has lost over \$216 million in allocations since 1989. In effect, Arizona's taxpayers subsidize infrastructure in other states and pay more for the same infrastructure within Arizona as the result of the funding disparity.

#### FINANCIAL CONTACT

The Authority's financial statements present users with a general overview of the Authority's finances and demonstrate the Authority's accountability. If you have any questions about the report or require additional financial information, please contact Don States, Controller, Water Infrastructure Finance Authority of Arizona, 1110 West Washington, Suite 290, Phoenix, Arizona 85007 or by phone at (602) 364-1324 or toll-free at (877) 298-0425.

WATER INFRASTRUCTURE FINANCE AUTHORITY OF ARIZONA  
STATEMENT OF NET ASSETS  
PROPRIETARY FUNDS  
June 30, 2006

ASSETS	Business-type Activities-Enterprise Funds			Total
	Clean Water Revolving Fund	Drinking Water Revolving Fund	Hardship Grant Fund	
Current assets				
Cash and cash equivalents				
Cash with treasurer	\$ 63,562,779	\$ 71,816,656	\$ 15,962	\$ 135,395,397
Cash with trustee	113,855,505	12,959,514	-	126,815,019
Total cash and cash equivalents	177,418,284	84,776,170	15,962	262,210,416
Receivables, net of uncollectibles				
Debt management	1,793,787	1,309,251	-	3,103,038
Interest	5,012,236	2,658,837	-	7,671,073
Due (to) from other funds	86,405	(154,605)	68,200	-
Total current assets	184,310,712	88,589,653	84,162	272,984,527
Noncurrent assets				
Investments	67,157,547	13,738,288	-	80,895,835
Program loans	415,588,073	159,347,018	-	574,935,091
Deferred bond costs	2,707,294	832,681	-	3,539,975
Capital assets (net of depreciation)	3,909	3,909	-	7,818
Total noncurrent assets	485,456,823	173,921,896	-	659,378,719
Total assets	669,767,535	262,511,549	84,162	932,363,246
LIABILITIES				
Current liabilities				
Accrued payroll	17,578	17,578	-	35,156
Compensated absences	29,300	29,300	-	58,600
Interest payable	3,392,074	1,720,310	-	5,112,384
Bonds payable-current	18,407,794	6,702,207	-	25,110,001
Total current liabilities	21,846,746	8,469,395	-	30,316,141
Noncurrent liabilities				
Loan reserve	241,519	2,113,214	-	2,354,733
Unamortized bond premiums	26,230,760	11,249,237	-	37,479,997
Deferred amount on retirement of bonds	(5,265,952)	(2,768,484)	-	(8,034,436)
Bonds payable	417,261,836	140,188,163	-	557,449,999
Total noncurrent liabilities	438,468,163	150,782,130	-	589,250,293
Total liabilities	460,314,909	159,251,525	-	619,566,434
NET ASSETS				
Net assets invested in capital assets	3,909	3,909	-	7,818
Restricted for capitalization grants	171,599,254	89,557,213	-	261,156,467
Unrestricted	37,849,463	13,698,902	84,162	51,632,527
Total net assets	\$ 209,452,626	\$ 103,260,024	\$ 84,162	\$ 312,796,812

See accompanying notes.

WATER INFRASTRUCTURE FINANCE AUTHORITY OF ARIZONA  
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN FUND NET ASSETS  
PROPRIETARY FUNDS  
Year Ended June 30, 2006

	Business-type Activities-Enterprise Funds			
	Clean Water Revolving Fund	Drinking Water Revolving Fund	Hardship Grant Fund	Total
Program revenues				
Program loan interest revenue	\$ 7,701,330	\$ 3,332,412	\$ -	\$ 11,033,742
Debt management fees	4,110,836	3,525,303	-	7,636,139
Total program revenues	<u>11,812,166</u>	<u>6,857,715</u>	<u>-</u>	<u>18,669,881</u>
Program expenses				
Administrative expenses	804,754	1,806,997	-	2,611,751
Depreciation	1,955	1,955	-	3,910
Technical assistance	35,390	384,681	-	420,071
Financial assistance	121,161	-	-	121,161
Program loan interest expense	12,046,318	5,351,568	-	17,397,886
Total program expenses	<u>13,009,578</u>	<u>7,545,201</u>	<u>-</u>	<u>20,554,779</u>
Program loss	<u>(1,197,412)</u>	<u>(687,486)</u>	<u>-</u>	<u>(1,884,898)</u>
Nonprogram revenues				
Administrative grants	320,944	860,318	-	1,181,262
Investment earnings	6,642,024	3,378,772	-	10,020,796
Total nonprogram revenues	<u>6,962,968</u>	<u>4,239,090</u>	<u>-</u>	<u>11,202,058</u>
Income before contributions and transfers	5,765,556	3,551,604	-	9,317,160
Capital contributions-federal	6,995,769	11,635,862	-	18,631,631
Capital contributions-state	893,200	1,551,900	-	2,445,100
Change in net assets	<u>13,654,525</u>	<u>16,739,366</u>	<u>-</u>	<u>30,393,891</u>
Total net assets-beginning of year	195,798,101	86,520,658	84,162	282,402,921
Total net assets-end of year	<u>\$ 209,452,626</u>	<u>\$ 103,260,024</u>	<u>\$ 84,162</u>	<u>\$ 312,796,812</u>

WATER INFRASTRUCTURE FINANCE AUTHORITY OF ARIZONA  
STATEMENT OF CASH FLOWS  
PROPRIETARY FUNDS  
Year Ended June 30, 2006

CASH FLOWS FROM OPERATING ACTIVITIES	Business-type Activities-Enterprise Funds			Total
	Clean Water Revolving Fund	Drinking Water Revolving Fund	Hardship Grant Fund	
Receipt of program loans	\$ 29,922,325	\$ 11,113,856	\$ -	\$ 41,036,181
Loans made to borrowers	(89,221,364)	(27,950,278)	-	(117,171,642)
Receipt of debt management fees	3,674,167	2,968,739	-	6,642,906
Receipt of loan reserves	26,936	305,694	-	332,630
Payment of administrative costs	(778,714)	(1,780,957)	-	(2,559,671)
Payment of technical assistance costs	(35,390)	(384,681)	-	(420,071)
Payment of financial assistance costs	(121,161)	-	-	(121,161)
Payment of program loan costs	(12,916,078)	(5,453,211)	-	(18,369,289)
Net cash used by operating activities	(69,449,279)	(21,180,838)	-	(90,630,117)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES				
Principal paid on bonds	(20,390,323)	(8,124,677)	-	(28,515,000)
Receipts from new bond issue	181,818,731	33,351,365	-	215,170,096
Interfund receipts (payments)	2,122,048	(2,122,048)	-	-
Receipt of administrative grants	320,944	860,318	-	1,181,262
Capital contributions	7,888,969	13,187,762	-	21,076,731
Net cash provided by noncapital financing activities	171,760,369	37,152,720	-	208,913,089
CASH FLOWS FROM INVESTING ACTIVITIES				
Purchase of investments	(10,465,028)	(2,348,997)	-	(12,814,025)
Interest received on investments	6,003,925	2,991,225	-	8,995,150
Net cash provided (used) by investing activities	(4,461,103)	642,228	-	(3,818,875)
Net increase in cash and cash equivalents	97,849,987	16,614,110	-	114,464,097
Cash and cash equivalents at beginning of year	79,568,297	68,162,060	15,962	147,746,319
Cash and cash equivalents at end of year	\$ 177,418,284	\$ 84,776,170	\$ 15,962	\$ 262,210,416

See accompanying notes.

	Business-type Activities-Enterprise Funds			Total
	Clean Water Revolving Fund	Drinking Water Revolving Fund	Hardship Grant Fund	
Reconciliation of program loss to net cash used by operating activities				
Program loss	\$ (1,197,412)	\$ (687,486)	\$ -	\$ (1,884,898)
Adjustments to reconcile program loss to net cash used by operating activities:				
Depreciation	1,955	1,955	-	3,910
Amortization of bond related costs	(635,296)	(420,609)	-	(1,055,905)
(Increase) decrease in				
Program loans	(66,494,329)	(19,368,909)	-	(85,863,238)
Debt management receivable	(436,669)	(556,564)	-	(993,233)
Interest receivable	(506,040)	(799,925)	-	(1,305,965)
Increase (decrease) in				
Accrued payroll	9,747	9,747	-	19,494
Compensated absences	16,293	16,293	-	32,586
Interest payable	(234,464)	318,966	-	84,502
Loan reserve	26,936	305,694	-	332,630
Total adjustments	(68,251,867)	(20,493,352)	-	(88,745,219)
Net cash used by operating activities	\$ (69,449,279)	\$ (21,180,838)	\$ -	\$ (90,630,117)

WATER INFRASTRUCTURE FINANCE AUTHORITY OF ARIZONA  
NOTES TO FINANCIAL STATEMENTS  
June 30, 2006

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Reporting Entity (Continued)

The accompanying financial statements present the Clean Water Revolving Fund, Drinking Water Revolving Fund and the Hardship Grant Fund, which includes all of the revenues and the administrative expenses of WIFA.

Fund Type

WIFA plans to maintain the federal capitalization grants as the fund's restricted net assets. Therefore, the periodic determination of revenues earned, expenses incurred, and changes in net assets are appropriate for capital maintenance, public policy, management control, accountability and other purposes. As a result, the accounting records are maintained as an enterprise fund. Only earnings from the administrative grants, debt management fees and interest earned on accumulated excess administrative income can be expended for expenses or utilized to match federal grants.

WIFA distinguishes program revenues and expenses from non-program items. Program revenues and expenses generally result from providing services in connection with financing and administering moneys for the Clean and Drinking Water Revolving Funds. The principal program revenues of WIFA are program loan interest and management fees. WIFA's program expenses are administrative, program loan costs and grant related expenses. All revenues and expenses not meeting this definition are reported as non-program revenues and expenses.

Measurement Focus and Basis of Accounting

The accounting and financial reporting treatment applied to a fund is determined by its measurement focus. WIFA's financial statements are reported using the economic resources measurement focus. WIFA's accounting records are maintained on the accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized when they are earned and expenses are recognized when they are incurred. Pursuant to Governmental Accounting Standards Board (GASB) Statement No. 20, Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that use Proprietary Fund Accounting, the WIFA follows GASB guidance as applicable to proprietary funds, and Financial Accounting Standards Boards Statements and Interpretations, Accounting Principles Board Opinions, and Accounting Research Bulletins issued on or before November 30, 1989 that do not conflict with or contradict GASB Pronouncements.

WATER INFRASTRUCTURE FINANCE AUTHORITY OF ARIZONA  
NOTES TO FINANCIAL STATEMENTS  
June 30, 2006

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Investments

WIFA has adopted provisions of Statement No. 31 of the Governmental Accounting Standards Board, Accounting and Financial Reporting for Certain Investments and for External Investment Pools. This standard requires certain investments to be reported at fair value rather than at cost.

Investments in Guaranteed Investment Contracts are stated at cost, since they are non-participating contracts. The investment of excess revenue in the 2001 Master Trust Indenture is stated at fair value, which approximates cost.

Cash Equivalents

WIFA considers all highly liquid debt instruments purchased with maturities of three months or less at acquisition date to be cash equivalents. Cash equivalents are stated at cost, which approximates market.

Capital Assets

Capital assets acquired by the Funds are stated at cost. The capitalization threshold has been set at \$5,000. Depreciation has been allocated using the straight-line method over the following estimated useful lives:

Computer and Peripheral Equipment	3 - 5 years
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Compensated Absences

WIFA employees accrue vested annual leave at a variable rate based on years of service. Employees forfeit accumulated annual leave in excess of 320 hours at the end of a calendar year. Any employee who separates from WIFA service is paid for all unused and unforfeited annual leave at the employee's rate of pay at the time of separation.

Sick leave includes any approved period of paid absence granted an employee due to illness, injury or disability. Employees accrue sick leave at the rate of eight hours per month without an accumulation limit. Because sick leave benefits do not vest with employees, a liability for sick leave is not accrued in the financial statements.

WATER INFRASTRUCTURE FINANCE AUTHORITY OF ARIZONA  
NOTES TO FINANCIAL STATEMENTS  
June 30, 2006

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Long-term Obligations

Long-term debt is reported as fund liabilities in the applicable fund's statement of net assets. Bond premiums, bond issuance costs and loss on retirement of bonds are deferred and amortized over the life of the bonds using the straight-line method.

Net Assets

WIFA restricts amounts received from the federal and state government for the purpose of providing financial assistance for publicly owned wastewater treatment and water facilities.

Grants

Grants restricted for program loans are recorded as contributions. Grants that are used for operating purposes are recorded as revenue. Federal grants for project related expenses may not be drawn until qualifying expenditures are incurred.

Fund Administration

Employees of WIFA perform administration of the Funds. Expenses relating to the administration are funded from the capital facility grant (up to a maximum of 4 percent of the capital facility grant) and fees charged to loan recipients (see Note 8).

Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

WATER INFRASTRUCTURE FINANCE AUTHORITY OF ARIZONA  
NOTES TO FINANCIAL STATEMENTS  
June 30, 2006

NOTE 2 CASH AND INVESTMENTS

Cash Deposits

Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, an entity will not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party.

At June 30, 2006, the carrying amount of WIFA's cash with treasurer totaled \$135,395,397 of which \$133,532,395 was invested in the State Agency's pool number 3. A copy of the audited financial statements may be obtained by contacting the Office of the State Treasurer.

At June 30, 2006, the carrying amount of WIFA's cash with trustee totaled \$126,815,019 of which \$126,699,521 was invested in money market funds. WIFA maintains their cash held by trustee in an irrevocable trust account in the name of WIFA held by the trust department of a financial institution located in Phoenix, Arizona (separate from all other funds and investments of the trustee). These balances are directed by the State Treasurer to be invested in a full faith and credit money market fund that is not insured by the Federal Deposit Insurance Corporation or collateralized by the trustee.

Investments

The State Treasurer directs WIFA's investments. ARS 35-312 and ARS 35-313 require the State Treasurer to invest in obligations of the U.S. or its agencies including sponsored agencies, corporations, sponsored corporations or instrumentalities, collateralized repurchase agreements, bonds or other evidence of indebtedness of the State of Arizona or its political subdivisions, commercial paper, bankers acceptances, certificates of deposit, interest-bearing savings accounts and bonds, debentures, notes and other evidences of indebtedness issued by U.S. corporations meeting certain rating criteria. WIFA's investments at June 30, 2006, consisted of collateralized guaranteed investment contracts issued by domestic banks, a monoline insurer and insurance company, and a foreign bank acting through its New York branch. The guaranteed investment contracts are not insured by the Federal Deposit Insurance Corporation.

Interest Rate Risk

Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in market interest rates. Information about the sensitivity of the fair values of WIFA's investments to market interest rate fluctuations is provided by the following table that shows the distribution of WIFA's investments by maturity:

WATER INFRASTRUCTURE FINANCE AUTHORITY OF ARIZONA  
NOTES TO FINANCIAL STATEMENTS  
June 30, 2006

NOTE 2 CASH AND INVESTMENTS (Continued)

Investment Type		Remaining Maturity (In Months)			
		12 Months or Less	13 to 24 Months	25 to 60 Months	More Than 60 Months
State Investment Pool	\$ 133,532,395	\$ 133,532,395	\$ -	\$ -	\$ -
Money Market Funds	126,699,521	126,699,521	-	-	-
Guaranteed Investment Contracts	80,895,835	-	-	13,576,870	67,318,965
	<u>\$ 341,127,751</u>	<u>\$ 260,231,916</u>	<u>\$ -</u>	<u>\$ 13,576,870</u>	<u>\$ 67,318,965</u>

Credit Risk

Credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization. Presented below is the Standard & Poor's rating as of year-end for each investment type.

Investment Type		Ratings as of Year-End			
		AAA	AA	A	Unrated
State Investment Pool	\$ 133,532,395	\$ -	\$ -	\$ -	\$ 133,532,395
Money Market Funds	126,699,521	-	-	-	126,699,521
Guaranteed Investment Contracts	80,895,835	80,895,835	-	-	-
	<u>\$ 341,127,751</u>	<u>\$ 80,895,835</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 260,231,916</u>

If any of the bank's credit rating falls below levels defined in the investment contracts, the State Treasurer may direct the bank to enter into a repurchase agreement with the Trustee pursuant to which the bank shall sell and deliver to the Trustee certain U.S. government obligations in a principal amount equal to invested moneys and accrued interest. If the rating falls below "A" the Trustee shall have the right to withdraw all amounts invested and accrued interest.

Concentration of Credit Risk

The investment policy of WIFA contains no limitations on the amount that can be invested in any one issuer. Investments in any one issuer are as follows:

Issuer	Investment Type	Reported Amount
State Investment Pool	State Investment Pool	\$ 133,532,395
First American Prime Obligations Fund	Money Market	126,699,521
Bayerische Landesbank	Guaranteed Investment Contract	40,585,506
AIG Matched Funding Corp.	Guaranteed Investment Contract	25,152,511
Royal Bank of Canada		15,157,818
		<u>\$ 341,127,751</u>

WATER INFRASTRUCTURE FINANCE AUTHORITY OF ARIZONA  
NOTES TO FINANCIAL STATEMENTS  
June 30, 2006

NOTE 3 PROGRAM LOANS

The Funds have made loans to local governments and others in Arizona to finance various projects pursuant to the requirements of the Clean Water and Safe Drinking Water Acts. The loans are generally payable in semiannual installments due January 1 and July 1 of each year, including interest. However, several loans are payable monthly or quarterly. Changes in the program loans are as follows:

	<u>July 1, 2005</u>	<u>Increases</u>	<u>Decreases</u>	<u>June 30, 2006</u>
Clean Water Fund	<u>\$ 349,093,744</u>	<u>\$ 89,221,364</u>	<u>\$(22,727,035)</u>	<u>\$ 415,588,073</u>
Drinking Water Fund	<u>139,978,109</u>	<u>27,950,278</u>	<u>(8,581,369)</u>	<u>159,347,018</u>
	<u><u>\$ 489,071,853</u></u>	<u><u>\$117,171,642</u></u>	<u><u>\$(31,308,404)</u></u>	<u><u>\$ 574,935,091</u></u>

Repayment of these loans will be made from pledged property taxes, net revenues from the systems, transaction privilege taxes or from special assessments. Most loans have a .3 to 4.0 percent annual administrative fee.

Some program loans require a monthly or quarterly payment into a debt service reserve to assure payments of the loans. The debt service reserve is a liability of WIFA to the borrowers and interest on the reserve accrues to the borrowers.

NOTE 4 CAPITAL ASSETS

Capital asset activity for the year ended June 30, 2006 was as follows:

	<u>Beginning Balance</u>	<u>Increases</u>	<u>Decreases</u>	<u>Ending Balance</u>
Clean Water Fund				
Computers & Peripheral Equipment	<u>\$ 50,733</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 50,733</u>
Less Accumulated Depreciation	<u>(44,869)</u>	<u>(1,955)</u>	<u>-</u>	<u>(46,824)</u>
Clean Water Capital Assets, net	<u>5,864</u>	<u>(1,955)</u>	<u>-</u>	<u>3,909</u>
Drinking Water Fund				
Computers & Peripheral Equipment	<u>50,733</u>	<u>-</u>	<u>-</u>	<u>50,733</u>
Less Accumulated Depreciation	<u>(44,869)</u>	<u>(1,955)</u>	<u>-</u>	<u>(46,824)</u>
Drinking Water Capital Assets, net	<u>5,864</u>	<u>(1,955)</u>	<u>-</u>	<u>3,909</u>
Clean and Drinking Water Funds				
Computers & Peripheral Equipment	<u>101,466</u>	<u>-</u>	<u>-</u>	<u>101,466</u>
Less Accumulated Depreciation	<u>(89,738)</u>	<u>(3,910)</u>	<u>-</u>	<u>(93,648)</u>
Clean and Drinking Water Capital Assets, net	<u><u>\$ 11,728</u></u>	<u><u>\$ (3,910)</u></u>	<u><u>\$ -</u></u>	<u><u>\$ 7,818</u></u>

WATER INFRASTRUCTURE FINANCE AUTHORITY OF ARIZONA  
NOTES TO FINANCIAL STATEMENTS  
June 30, 2006

NOTE 5 COMPENSATED ABSENCES

The compensated absences activity for June 30, 2006 was as follows:

Compensated Absences for:	July 1, 2005	Additions	Reductions	June 30, 2006	Estimated Current Portion
Clean Water	\$ 13,007	\$ 23,634	\$ (7,341)	\$ 29,300	\$ 29,300
Drinking Water	13,007	23,634	(7,341)	29,300	29,300
Total	<u>\$ 26,014</u>	<u>\$ 47,268</u>	<u>\$ (14,682)</u>	<u>\$ 58,600</u>	<u>\$ 58,600</u>

NOTE 6 RETIREMENT AND PENSION PLAN

Arizona State Retirement Plan

Plan Description. The Arizona State Retirement System (ASRS) administers a cost sharing multiple-employer defined benefit pension plan that covers employees of WIFA. The ASRS is governed by the Arizona State Retirement System Board according to the provisions of A.R.S. Title 38, Chapter 5, Article 2. Benefits are established by state statute and generally provide retirement, death, long-term disability, survivor, and health insurance premium benefits. ASRS issues a publicly available report that includes financial statements and required supplementary information. The report may be obtained in writing at ASRS, 3300 N. Central Avenue, P.O. Box 33910, Phoenix, Arizona 85067-3910 or by calling 602-240-2200 or 1-800-621-3778.

Funding Policy. The Arizona State Legislature has the authority to establish and amend benefits provisions and contributions for active plan members. For the years ended June 30, 2006, 2005 and 2004, active ASRS members and the District were each required by statute to contribute at the actuarially determined rate of 7.40, 5.70 and 5.70 percent (rate includes .50 for long-term disability), respectively, of the members' annual covered payroll. WIFA's contributions to ASRS for the years ended June 30, 2006, 2005 and 2004 were \$46,917, \$41,745 and \$43,222, respectively.

NOTE 7 BONDS PAYABLE

Bonds payable at June 30, 2006 are summarized below. The bonds are callable and interest is payable semiannually. The bonds are special obligations of WIFA payable solely from and secured by the Fund's assets. The obligations are not obligations, general, specific or otherwise, of the State of Arizona or any other political subdivision thereof other than WIFA.

WATER INFRASTRUCTURE FINANCE AUTHORITY OF ARIZONA  
NOTES TO FINANCIAL STATEMENTS  
June 30, 2006

NOTE 7 BONDS PAYABLE (Continued)

\$3,270,000 Financial Assistance Revenue Bonds, Series 1995, due in annual principal installments ranging from \$225,000 to \$410,000, plus semiannual interest ranging from 4.40% to 5.50% through July 1, 2009.	\$1,615,000
\$9,730,000 Financial Assistance Revenue Bonds, Series 1996A, due in annual principal installments ranging from \$360,000 to \$1,870,000, plus semiannual interest ranging from 3.70% to 5.50% through July 1, 2012.	8,140,000
\$20,125,000 Financial Assistance Revenue Bonds, Series 1997A, due in annual principal installments ranging from \$845,000 to \$1,415,000, plus semiannual interest ranging from 4.20% to 6.1% through July 1, 2008.	4,030,000
\$35,370,000 Financial Assistance Revenue Bonds, Series 1998A, due in annual principal installments ranging from \$1,985,000 to \$2,190,000, beginning July 1, 1999, plus semiannual interest ranging from 3.8% to 5% through July 1, 2008.	5,925,000
\$64,000,000 Water Quality Revenue Refunding Bonds, Series 1999, due in annual principal installments ranging from \$2,330,000 to \$8,190,000, plus semiannual interest ranging from 4.0% to 5.625% through October 1, 2017.	51,405,000
\$110,000,000 Water Quality Revenue Bonds, Series 2001A, due in annual principal installments ranging from \$3,780,000 to \$8,075,000, plus semiannual interest ranging from 4.0% to 5.375% through October 1, 2011.	28,995,000
\$195,980,000 Water Quality Revenue Bonds, Series 2004, due in annual principal installments ranging from \$5,500,000 to \$15,080,000, plus semi annual interest ranging from 2.0% to 5.0% through October 1, 2024.	180,900,000
\$97,100,000 Water Quality Revenue Refunding Bonds, Series 2004, due in annual principal installments ranging from \$125,000 to \$4,825,000, plus semi annual interest ranging from 2.0% to 5.0% through October 1, 2021.	96,150,000

WATER INFRASTRUCTURE FINANCE AUTHORITY OF ARIZONA  
NOTES TO FINANCIAL STATEMENTS  
June 30, 2006

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

The Water Infrastructure Finance Authority of Arizona (WIFA) is a political body and a component unit of the State of Arizona (State). WIFA's financial information is discretely presented in the Comprehensive Annual Financial Report of the State of Arizona. It is authorized to administer the Clean Water Revolving Fund and The Drinking Water Revolving Fund (Funds). WIFA is governed by a twelve-member board of directors. The day-to-day administrative functions of WIFA are overseen by WIFA's Executive Director and other staff employed by WIFA.

The Clean Water Revolving Fund was created pursuant to the Federal Water Pollution Control Act of 1972, as amended by the Water Quality Act of 1987 (Clean Water Act), which required the State of Arizona to establish the Fund to accept federal capitalization grants for publicly owned wastewater treatment projects. The purpose of the fund is to provide financial assistance, including loans to political subdivisions and Indian tribes to finance construction, acquisition, restoration or rebuilding of wastewater treatment facilities.

WIFA has an agreement with the Environmental Protection Agency to administer the Drinking Water Revolving Fund pursuant to the Safe Drinking Water Act. The fund was established to provide water facility loans including forgivable principal to political subdivisions of this state, Indian Tribes and other eligible entities as determined by the board pursuant to the Safe Drinking Water Act, make drinking water facility loans, purchase or refinance debt obligations of drinking water facilities, assist in purchasing insurance for local drinking water facility bond obligations, pay the costs to administer the fund, fund other programs pursuant to the Safe Drinking Water Act and provide linked deposit guarantees through third party lenders with recourse against deposit if payments are not made when due.

The Funds are authorized to be capitalized through ( i ) moneys, if any, appropriated by the State Legislature, ( ii ) federal capitalization grants and other federal moneys received by WIFA to fund the Fund, ( iii ) proceeds of WIFA's bonds, including bonds issued to provide matching State moneys as required by the Clean Water Act, ( iv ) moneys received from political subdivisions or Indian tribes as repayment of loans from the Fund, including interest and penalties thereon, ( v ) interest and other income received from investing moneys of the Fund, and ( vi ) gifts, grants and donations received from any public or private source. In order to receive federal capitalization grants, the State must provide matching funds in a ratio of \$1 of State matching funds for every \$5 of federal capitalization grants. The State began appropriating money for deposit into the Funds in 1998. Previously the State matching funds were provided from proceeds of the WIFA's capitalization bonds.

WATER INFRASTRUCTURE FINANCE AUTHORITY OF ARIZONA  
NOTES TO FINANCIAL STATEMENTS  
June 30, 2006

NOTE 7 BONDS PAYABLE (Continued)

\$205,400,000 Water Quality Revenue Bonds, Series 2006, due in annual principal installments ranging from \$2,875,000 to \$16,750,000, plus semi annual interest ranging from 3.75% to 5.0% through October 1, 2026.

205,400,000  
\$ 582,560,000

A summary of changes in bonds payable is set forth below:

	July 1, 2005	Issued	Retired	June 30, 2006
Financial Assistance Revenue Bonds Series 1995	\$ 1,935,000	\$ -	\$ 320,000	\$ 1,615,000
Capitalization Revenue Bonds Series 1995	125,000	-	125,000	-
Financial Assistance Revenue Bonds Series 1996A	9,370,000	-	1,230,000	8,140,000
Capitalization Revenue Bonds Series 1996A	220,000	-	220,000	-
Financial Assistance Revenue Bonds Series 1997A	5,035,000	-	1,005,000	4,030,000
Capitalization Revenue Bonds Series 1997A	625,000	-	625,000	-
Financial Assistance Revenue Bonds Series 1998A	7,875,000	-	1,950,000	5,925,000
Water Quality Refunding Bonds Series 1999	54,255,000	-	2,850,000	51,405,000
Water Quality Revenue Bonds Series 2001A	33,280,000	-	4,285,000	28,995,000
Water Quality Revenue Bonds Series 2004A	195,980,000	-	15,080,000	180,900,000
Water Quality Refunding Bonds Series 2004A	96,975,000	-	825,000	96,150,000
Water Quality Revenue Bonds Series 2006A	-	205,400,000	-	205,400,000
	<u>\$ 405,675,000</u>	<u>\$205,400,000</u>	<u>\$28,515,000</u>	<u>\$582,560,000</u>

Bonds by Fund are as follows:

Arizona Clean Water Revolving Fund	\$ 435,669,630
Arizona Drinking Water Revolving Fund	146,890,370
	<u>\$ 582,560,000</u>

WATER INFRASTRUCTURE FINANCE AUTHORITY OF ARIZONA  
NOTES TO FINANCIAL STATEMENTS  
June 30, 2006

NOTE 7 BONDS PAYABLE (Continued)

The Clean Water Fund's bond debt service requirements to maturity, including interest, are as follows:

Year Ending June 30,	Clean Water		
	Principal	Interest	Total
2007	\$ 18,407,794	\$ 20,539,087	\$ 38,946,881
2008	19,107,779	19,718,705	38,826,484
2009	20,409,305	18,850,043	39,259,348
2010	19,135,875	17,982,472	37,118,347
2011	20,230,132	17,088,876	37,319,008
2012-2016	118,913,318	68,529,954	187,443,272
2017-2021	114,753,022	39,312,780	154,065,802
2022-2026	90,558,655	13,115,372	103,674,027
2027-2031	14,153,750	309,613	14,463,363
Total Long-Term Debt	435,669,630	215,446,902	651,116,532
Less Current Portion	(18,407,794)	(20,539,087)	(38,946,881)
Noncurrent Portion	\$ 417,261,836	\$ 194,907,815	\$ 612,169,651

The Drinking Water Fund's bond debt service requirements to maturity, including interest, are as follows:

Year Ending June 30,	Drinking Water		
	Principal	Interest	Total
2007	\$ 6,702,207	\$ 6,712,229	\$ 13,414,436
2008	6,792,220	6,453,098	13,245,318
2009	7,010,695	6,156,721	13,167,416
2010	7,709,125	5,837,409	13,546,534
2011	7,789,868	5,490,572	13,280,440
2012-2016	38,981,682	21,923,773	60,905,455
2017-2021	40,766,977	12,381,120	53,148,097
2022-2026	28,541,346	3,159,107	31,700,453
2027-2031	2,596,250	56,793	2,653,043
Total Long-Term Debt	146,890,370	68,170,822	215,061,192
Less Current Portion	(6,702,207)	(6,712,229)	(13,414,436)
Noncurrent Portion	\$ 140,188,163	\$ 61,458,593	\$ 201,646,756

WATER INFRASTRUCTURE FINANCE AUTHORITY OF ARIZONA  
NOTES TO FINANCIAL STATEMENTS  
June 30, 2006

NOTE 7 BONDS PAYABLE (Continued)

WIFA's total bond debt service requirements to maturity, including interest, are as follows:

Year Ending June 30,	Total Clean and Drinking Water		
	Principal	Interest	Total
2007	\$ 25,110,001	\$ 27,251,316	\$ 52,361,317
2008	25,899,999	26,171,803	52,071,802
2009	27,420,000	25,006,764	52,426,764
2010	26,845,000	23,819,881	50,664,881
2011	28,020,000	22,579,448	50,599,448
2012-2016	157,895,000	90,453,727	248,348,727
2017-2021	155,519,999	51,693,900	207,213,899
2022-2026	119,100,001	16,274,479	135,374,480
2027-2031	16,750,000	366,406	17,116,406
Total Long-Term Debt	582,560,000	283,617,724	866,177,724
Less Current Portion	(25,110,001)	(27,251,316)	(52,361,317)
Noncurrent Portion	\$ 557,449,999	\$ 256,366,408	\$ 813,816,407

On September 8, 1999, WIFA issued \$64,000,000 of Water Quality Refunding Bonds to do an advance refunding of the 1991A bonds and part of the 1992A, 1995A and 1996A bonds. Under the terms of the refunding issue, sufficient assets to pay all principal and interest on the refunded bond issues have been placed in irrevocable trust accounts at commercial banks and invested in U.S. Government Securities which, together with interest earned thereon, will provide amounts sufficient for future payment of principal and interest of the issues refunded. The amount outstanding on those bonds as of June 30, 2006 is \$14,995,000. These bonds have been fully defeased.

The net present value cash flow for savings on issuing the refunding bonds at a 5.271% bond yield was \$237,387.

On April 7, 2004, WIFA issued \$97,100,000 of Water Quality Refunding Bonds to do an advance refunding part of the 1992, 1997A, 1998A and 2001 bonds. Under the terms of the refunding issue, sufficient assets to pay all principal and interest on the refunded bond issues have been placed in irrevocable trust accounts at commercial banks and invested in U.S. Government Securities which, together with interest earned thereon, will provide amounts sufficient for future payment of principal and interest of the issues refunded. The amount outstanding on those bonds as of June 30, 2006 is \$91,215,000. These bonds have been fully defeased.

The net present value cash flow for savings on issuing the refunding bonds at a 3.213% bond yield was \$3,120,247.

WATER INFRASTRUCTURE FINANCE AUTHORITY OF ARIZONA  
NOTES TO FINANCIAL STATEMENTS  
June 30, 2006

NOTE 7 BONDS PAYABLE (Continued)

The \$8,034,436 deferred amount on retirement of bonds is being amortized over the lives of the defeased bonds on the straight-line basis. Annual amortization is \$401,061 and \$173,030 for Clean Water Revolving and Drinking Water Revolving Funds, respectively. Amortization has been offset against interest expense.

NOTE 8 ADMINISTRATIVE REVENUES AND EXPENSES

WIFA is authorized to utilize a portion of the facility grant as an administrative grant (not to exceed 4% of the net capital facility grant). These funds are deposited to an administrative grant account maintained by WIFA which is accounted for in a separate fund at the treasurer's office.

WIFA also receives a loan origination fee on most loans and servicing fees assessed on the outstanding loan balance from each of the local borrowers (Debt Management Revenue). These fees are used to defray program administration expenses, and are collected and recorded by WIFA as separate funds at the treasurer's office.

The administrative expenses reported by WIFA for the year ended June 30, 2006 are as follows:

EXPENSES:	Clean Water Fund	Drinking Water Fund	Total
Personnel	\$ 397,229	\$ 241,079	\$ 638,308
Benefits	113,563	71,468	185,031
Contracts	71,184	61,386	132,570
In State Travel	5,998	5,998	11,996
Out of State Travel	5,463	5,473	10,936
Other operating expenses	67,828	66,825	134,653
Capital and non-capital equipment	7,039	7,040	14,079
Indirect cost	21,250	21,250	42,500
Other operating expenses	115,200	20,700	135,900
Subtotal	804,754	501,219	1,305,973
Set aside to ADEQ	-	1,305,778	1,305,778
	<u>\$ 804,754</u>	<u>\$ 1,806,997</u>	<u>\$ 2,611,751</u>

WATER INFRASTRUCTURE FINANCE AUTHORITY OF ARIZONA  
NOTES TO FINANCIAL STATEMENTS  
June 30, 2006

NOTE 9 AMORTIZATION OF BOND COSTS AND BOND PREMIUMS

WIFA has incurred costs for issuance of bonds, which were not passed on to the borrowers. Such costs are being amortized over the life of the bonds on the straight-line basis. Amortization has been offset against interest expense. Annual amortization for the following bonds is \$139,954 and \$49,853 for Clean Water Revolving and Drinking Water Revolving Funds, respectively. The details follow:

	<u>July 1, 2005</u>	<u>Additions</u>	<u>Amortization</u>	<u>June 30, 2006</u>
Clean Water Fund:				
1996A Bonds	\$ 80,051	\$ -	\$ (7,504)	\$ 72,547
1997 Bonds	22,223	-	(5,556)	16,667
1998 Bonds	7,671	-	(2,557)	5,114
1999 Bonds	493,606	-	(40,571)	453,035
2001 Bonds	115,906	-	(19,318)	96,588
2004 Bonds	1,009,337	-	(50,467)	958,870
2006 Bonds	-	1,118,454	(13,981)	1,104,473
Drinking Water Fund:				
1998 Bonds	3,783	-	(1,261)	2,522
2001 Bonds	105,839	-	(17,640)	88,199
2004 Bonds	567,752	-	(28,388)	539,364
2006 Bonds	-	205,160	(2,564)	202,596
	<u>\$ 2,406,168</u>	<u>\$ 1,323,614</u>	<u>\$ (189,807)</u>	<u>\$ 3,539,975</u>

Bond premiums are being amortized over the life of the bonds. Annual amortization for the following bonds is \$1,176,310 and \$643,492 for Clean Water Revolving and Drinking Water Revolving Funds, respectively. The details follow:

	<u>July 1, 2005</u>	<u>Additions</u>	<u>Amortization</u>	<u>June 30, 2006</u>
Clean Water Fund:				
1998 Bonds	\$ 24,331	\$ -	\$ (8,110)	\$ 16,221
1999 Bonds	135,817	-	(11,163)	124,654
2001 Bonds	704,529	-	(117,421)	587,108
2004 Bonds	17,168,208	-	(922,439)	16,245,769
2006 Bonds	-	9,374,185	(117,177)	9,257,008
Drinking Water Fund:				
1998 Bonds	7,590	-	(2,530)	5,060
2001 Bonds	643,332	-	(107,222)	536,110
2004 Bonds	9,522,282	-	(512,246)	9,010,036
2006 Bonds	-	1,719,525	(21,494)	1,698,031
	<u>\$28,206,089</u>	<u>\$11,093,710</u>	<u>\$(1,819,802)</u>	<u>\$37,479,997</u>

WATER INFRASTRUCTURE FINANCE AUTHORITY OF ARIZONA  
PHOENIX, ARIZONA

COMPLIANCE REPORT

Year Ended June 30, 2006



HENRY & HORNE, LLP

Advisors to Business

REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND  
ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF  
FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH  
GOVERNMENT AUDITING STANDARDS

Board of Directors  
Water Infrastructure Finance Authority of Arizona  
Phoenix, Arizona

We have audited the financial statements of the Water Infrastructure Finance Authority of Arizona as of and for the year ended June 30, 2006, and have issued our report thereon dated October 6, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Water Infrastructure Finance Authority of Arizona's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Water Infrastructure Finance Authority of Arizona's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We noted other matters involving the internal control over financial reporting that we have reported to management of Water Infrastructure Finance Authority of Arizona, in a separate letter dated October 6, 2006.

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CERTIFIED PUBLIC ACCOUNTANTS

This report is intended solely for the information of the audit committee, management and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

A handwritten signature in dark ink, appearing to read "Karen H. Hauer". The signature is fluid and cursive, with the first name "Karen" and last name "Hauer" clearly distinguishable.

October 6, 2006